

Testimony

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Mr. Chairman, thank you for the opportunity to testify today. Members of the Committee, welcome to Minnesota. And thank you for coming.

My name is Mark Davis and I've been in the dairy manufacturing business my whole life.

I was born into it. Growing up, my Dad was in the business. And my first job out of high school was driving a can milk pick up route.

I am now the President of Davisco Foods, a family owned company formed by the merger of the St. Peter Creamery and the Le Sueur Cheese Company in 1969. Our present headquarters is in Le Sueur, Minnesota. Davisco has cheese factories in Le Sueur, Jerome, Idaho and Lake Norden, South Dakota. With ingredient spray drying facilities in Le Sueur, Nicollet, Minnesota and Lake Norden, South Dakota.

As our dairy manufacturing business has grown and evolved we've established sales offices in Mexico City, Geneva, Switzerland, and, just recently, in Shanghai, China. We've worked with Japanese dairy processors for over 20 years.

When I was driving that milk pick-up route, I never dreamed milk production in Minnesota would drop more than 20 percent like it has between then and now.

So I want to take this opportunity to put some of those changes in context – especially with regard to federal dairy programs, which haven't changed that much since I started in the business.

... Let me comment first about one of the newest dairy programs: M-I-L-C, ... or the Milk Income Loss Contract program.

Now, I know this thing is politically popular in the Midwest ... but I have to call it like I see it. It is making dairy policy totally schizophrenic. It distorts the market signals.

It is the "Dr. Jekyll" program to the price support's "Mr. Hyde."

M-I-L-C is partially tied to production, but, only up to certain level of production. Many of the expanding dairy producers in the rapidly growing areas of the country are capped as to the volume of milk they can have subsidized.

M-I-L-C distorts the marketplace signals to the producers. They don't have to make economic and competitive enhancing investments, and, institute practices that increase their production efficiencies. One of the results being that Minnesota dairy farm production is not economically competitive with other growing production regions of the country. And soon neither will our manufacturing sector be competitive.

Thus, as prices recover, we, in the Midwest, will continue to lose dairy farms, and, discourage investment in what was once the premier dairy manufacturing region of this country.

So much for the market, and we manufacturers trying to make products and sell them.

M-I-L-C just makes a bad situation worse. Even without it, the price support program is causing serious problems in the marketplace.

Under the price support program handlers are essentially forced to make cheese, butter or powder. Why? ... If you try to make a derivative of one of those, the economics won't flow.

With this system, you are better off making nonfat milk, selling it to the government, and having the taxpayers supporting it. That whole system frustrates the marketing and the modernization of the U.S. dairy industry.

The bottom line is this: federal dairy programs are not flexible enough to keep up with market innovation. And market innovation is what sells more milk.

Whether it is for a manufacturer, or a producer.

Now let me tell you about an area where we have done some innovation: in whey. "Necessity is truly the Mother of Invention;" in this case "innovation."

And there are two reasons why we moved into whey production: first and foremost, because there are no price regulations to restrict us.

Secondly, because there's a demand, and, we had ever increasing volumes.

Whey protein naturally makes up about 20 percent of the total protein in milk. Whey proteins are quickly and easily digested, can aid in weight loss or muscle gain, and they are easily dissolved in water.

Besides various dairy products and bakery products, whey proteins are used in nutritional supplements, meat bindings, and even those little film strips that freshen your breath.

In other words, whey proteins expand the utilization of milk. Through innovation, and through *market* development.

But price supports even have an impact on the whey business.

Government warehouses, through the price support program, offer the best return on non-fat dry milk. And when the government buys milk powder week after week, month after month, year after year at prices way above their market value, we're ensured surpluses hanging over the market.

Liquidating those surpluses – no matter how carefully it is attempted to be structured – hits the dairy protein market.

In 2002, the USDA started giving away surplus milk powder for livestock feed in drought areas. Guess what, the more powder that came out of government storage – even though it was supposed to go to livestock feed – the more prices in the whey market were undermined.

My point is this: the federal government is acting as a willing buyer and seller of dairy products, and it is disrupting the normal commercial markets.

And, ... it sure disrupts the normal commercial markets when the government sets up all different kinds of pricing rules.

Although Davigco is one company, with one bottom line, we have three plants that are forced to operate under three sets of rules in buying milk

- In Le Sueur, we buy milk from independent farmers, and operate inside the federal milk marketing order. So we have to pay a minimum price under the order.
- In Lake Norden, South Dakota, we buy milk from a cooperative, who can originate milk under another set of unique rules – they are allowed to forward contract with producers. But get this, ... we are not allowed to forward contract with the co-op.
- In Jerome, Idaho, we buy milk from independent farmers operating outside the federal milk marketing order. We forward contract with them.

Three plants, three different sets of federal rules about how we buy milk. If we were in the grain business, or the meat business, we wouldn't face that.

We also had an important business tool taken away from us by Congress just recently.... forward contracting with all our suppliers. Which we still do in Idaho, ... and which we also did quite successfully in Minnesota.

Our program was a big success here in Minnesota. We don't have the ability to offer that service anymore because Congress let the federal program that allowed us to forward contract expire. Being in the business as long as we have, we know a fair amount about the economics of milk.

We buy milk in three states: inside the order, outside of the order, and from a co-op.

My son Mitch, who runs a farm, has learned a lot about the economics of *producing* milk.

So, when Congress allowed independent dairy plants to forward contract with farmers from 2000-2004, his brother – my other son Jon ... packaged together that knowledge as a service to our suppliers, and allowed them to forward contract their milk, and lock in a margin, just like farmers who supply a co-operative.

We really need to get back the opportunity to offer forward contracting inside the federal order just like cooperatives do — because our producers are requesting it.

And Mr. Chairman, I thank you for your leadership on this issue.

Forward contracting is a fair, effective tool that allows both the producer and the handler to manage price volatility.

Producers can service debt, they can expand, they can guarantee a profit – you are not going to go out of business when you have locked in a profit on every gallon of milk.

Manufacturers can do the same things too, and by managing input costs they can dedicate some resources to product innovation and development.

Cash flow is “Business 101” – and that’s what forward contracts help manage for both producer and manufacturer. That is why the cooperatives use it.

And that is why our suppliers outside the Federal Order system in Idaho use it.

You don’t have to just take my word for it. USDA conducted a study on forward contracting during the pilot program period it was allowed: from late 2000 through 2004.

USDA concluded it was a good tool to reduce price volatility.

And most interestingly, ... participation was highest where there was more than one buyer competing for milk.

Another example that the marketplace works. Competition works!

Our producers did not have to contract with us but if we were offering a competitive price, they did.

It is next to impossible to grow a business without tools like forward contracting – which are available to every business from supercomputers to jelly beans.

And today it is available to some dairy producers.

I'm not sure of the public policy goals of letting some producers use this tool, and not letting others use it.

To sum up this testimony, and a life time of experience in the dairy business, I want to sum up and underscore a few points:

- First, innovation and product development spell success in the dairy business.
- Second, current federal dairy policy strangles and chokes out innovation and product development.
- Third, having two dairy subsidy programs is just plain crazy -- there only needs to be one and it needs to get out of the way of markets.

Not a pretty picture, but the facts as I see them after nearly 50 years.

I want my sons and my grandchildren to have a future in this business, and I hope they can work with the sons and daughters and grandkids of our current suppliers – and new farmers who see an opportunity in dairying.

Because Davisco is not going to be making cheese and whey protein products if there is not a stable supply of milk,

But for all of our grandkids – manufacturer and producer – to have a future, we need to reform dairy policy. *NOW*.

The first step to real, equitable, and meaningful reform simply is not that complicated.

Just allow proprietary handlers and independent producers to enter into private, buy/sell, business contracts, that provide for cash forward sales.

All that would do is bring some fairness and business options to all producers and processors.

Locking in a profit is basic principle of economics, and fairness under the law it is a basic principal of America.

Thank you.